New FDIC Public-Private Approach To Sales of Loans From Failed Banks

Loans acquired by the Federal Deposit Insurance Corporation (FDIC) from failed financial institutions have historically been segregated into pools of loans with similar characteristics and then sold to private investors through sealed bid sales or English outcry auctions. Recently, however, the FDIC has adopted a new public-private sales approach for certain loan sales. Under this new approach, private investors are invited to bid on acquiring 100 percent of the interests in a limited liability company (LLC) formed by the FDIC to own the loans, rather than the loans themselves. The FDIC retains a participation interest in all future cash flows generated by the loans through a participation and servicing agreement with the LLC. The FDIC's participation interest is typically set at 80 percent initially, with a one-time decrease to 60 percent upon the FDIC's receipt of a threshold amount of proceeds (the actual participation interests and the threshold amount are specific to each transaction).

Other key features of this new approach include: (a) the LLC is responsible for asset management and ensuring that proper servicing and custodial arrangements are in place; (b) the LLC receives a monthly management fee (the fee is specific to each transaction); (c) the obligations of the LLC and the interest holder in the LLC must be guaranteed by a substantial entity that owns a majority interest in the interest holder (or such other guarantor as is acceptable to the FDIC); and (d) the FDIC has the right to require the sale of all remaining LLC assets upon the earlier of (i) the date the aggregate unpaid principal balance of the loans has been reduced to 10 percent of the unpaid principal balance existing at closing of the transaction and (ii) the seventh anniversary of the effective date of the participation and servicing agreement (tenth anniversary for LLCs with single-family residential loans).

Since December 2008, the FDIC has closed four loan sales with an aggregate book value of approximately $3.1 billion using this public-private partnership approach. Based on data provided by the FDIC, the average sales price was equal to approximately 22 percent of the book value of the initial 20 percent stake acquired by the winning bidder.

The FDIC's new public-private partnership approach to loan sales presents some unique investment opportunities using the FDIC as a money partner or for leverage. If you have any questions concerning this new development, please contact one of the attorneys listed below or your regular Ropes & Gray advisor.

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